

**In the Matter of the Application regarding the Conversion
of Premera Blue Cross and its Affiliates**

Washington State Insurance Commissioner: Docket No. G02-45

REPORT

of

**JOHN M. STEEL
Attorney-At-Law**

November 10, 2003

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This Report summarizes my conclusions relative to certain matters of Washington corporate law and practice that have arisen in connection with the above-referenced application for the conversion of PREMERA, a Washington miscellaneous not-for-profit corporation ("PREMERA"), Premera Blue Cross, a Washington not-for-profit corporation ("Premera BC" and, together with PREMERA, "Premera"), and various of their affiliates from not-for-profit to for-profit status under Washington law (the "Proposed Conversion"). The Proposed Conversion is more particularly described in the Form A (Statement Regarding the Acquisition of Control of a Domestic Health Carrier and a Domestic Insurer), filed by New PREMERA Corp. ("New PREMERA") with the Office of the Insurance Commissioner of the State of Washington ("OIC") on September 17, 2002, the supplementary materials filed by New PREMERA as part of the same Form A submission on September 27, 2002, and the further supplementary materials filed by New PREMERA as part of the same Form A submission on October 25, 2002 (the original Form A, together with the supplementary submissions to the OIC, being referred to herein as the "Form A Filing").

Materials Reviewed

In formulating the conclusions expressed herein, I have reviewed and relied upon various materials and other information made available to me, as described on attached Schedule A.¹

Qualifications for Conclusions Expressed

I am a 1967 graduate of Stanford University and a 1970 graduate of the University of Washington School of Law, where I ranked in the top 10% of my graduating class. I have been engaged in the full-time private practice of law in Seattle, Washington since 1970, and for over 31 of those years my practice has focused almost exclusively on corporate and securities law matters. During my career, I have negotiated and managed over 200 merger/acquisition transactions (including several sales or acquisitions of regulated insurers or healthcare service contractors), and have been primarily responsible for almost 30 initial public offerings (representing both issuers and underwriters, and including two IPOs in connection with conversions of mutual banks to for-profit status). I am currently a partner in the Gray Cary Ware & Freidenrich law firm, which has more than 400 lawyers located in eight offices across the country. Our firm has an active merger/acquisitions practice, which consistently ranks in the top twenty private law firms in the nation in the number of M&A transactions completed.

In the past three annual rankings of Washington lawyers, based on a peer survey conducted by *Washington Law & Politics*, I have been the highest-ranked corporate lawyer in Washington State. I am a long-time member of the Washington State Bar Association's Corporate Act Revision Committee, of which I was the Co-Chair for over ten years. I am also a former Chair of the Washington State Bar Association's Securities Law Committee.

My familiarity with Washington corporate law extends to nearly all of the statutes under which corporate entities may be organized in this state. I have authored and testified in favor of the legislative adoption of five separate amendments to the Washington Business Corporations Act (RCW Title 23B, applicable to for-profit corporations). I have also authored and supported the

¹ I have also reviewed various materials relating to the similar proceedings pending before the Alaska Division of Insurance. I expect to address those materials in a separate report that will be filed in Premera's Alaska proceedings.

legislative process as to two amendments to the not-for-profit statute under which PREMERA is organized (RCW Ch. 24.06), including a 2001 updating of that statute's provisions relating to directors' duties. In addition to the representation of numerous for-profit Washington corporations, I have represented numerous not-for-profit Washington corporations organized under RCW Ch. 24.03 and RCW Ch. 24.06 (including other healthcare service contractors), and have advised them as to governance, financing and transactional matters. I am frequently asked to speak at bar association, continuing education and industry group symposiums on matters of Washington corporate law, corporate governance and securities law.

Other than my engagement to offer my independent conclusions as to the matters addressed in this Report, neither I nor my law firm has any legal representation relationship with Premera BC, PREMERA, any of their existing affiliated entities, or any of the entities-to-be-formed that are identified in the Form A Filing as parties to the Proposed Conversion.

Conclusions as to Certain Matters of Washington Corporate Law and Practice

The preliminary and final reports from Cantilo & Bennett, LLP ("C&B") concerning the Form A Filing, dated October 3, 2003 and October 27, 2003, respectively (collectively referred to as the "C&B Report") have raised a number of questions as to whether certain aspects of the Form A Filing, or the corporate decision making processes underlying it, are in compliance with Washington laws applicable to corporations. I address several of those questions below.²

1. In reaching its decision to pursue the Proposed Conversion, the Premera Board fulfilled its fiduciary duties under Washington law in investigating and assessing alternatives for capital formation via possible merger or combination with other healthcare insurers.

The C&B Report has questioned whether the Board of Directors of PREMERA (the "PREMERA Board") and the Board of Directors of Premera BC (the "Premera BC Board" and, together with the PREMERA Board, the "Premera Board") satisfied their duties of care and "due diligence" relative to (1) identifying alternative means for improving Premera's capital base via a potential merger or combination with another healthcare insurer, (2) ruling out certain potential business combinations on the ground that they would result in a loss of independence and local control, and (3) investigating whether any merger or combination alternatives might have improved Premera's capital base while still allowing for maintenance of a strong "local presence."

a. *Factual Background of the Premera Board Deliberative Process.* Based on the background materials and information available to me, it appears to me that:

(1) the Premera Board grappled for an extended period of time (from at least 1997 forward) with the limitations and vulnerabilities arising out of its relatively limited capital base;

² If the Insurance Commissioner would like to hear testimony on the structure or terms of the Proposed Conversion from the perspective of an experienced securities lawyer, I will be prepared to address his questions.

(2) the Premera Board concluded in late 1997 that increasing Premera's capital base was a strategic priority in order for it to remain competitive and not be forced to artificially limit the growth of its business;

(3) in the latter half of the 1990's, the Premera Board engaged Goldman, Sachs & Company ("Goldman Sachs") to advise it with respect to its alternatives for increasing its capital base;

(4) Goldman Sachs delivered reports to the Premera Board in late 1997 that examined a wide range of capital enhancement alternatives, including an overview of business combination activities and considerations in the healthcare industry;

(5) the Premera Board already had a great deal of familiarity with the businesses and business practices of most of these potential combination candidates;

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(7) in mid-2001, the Premera Board again asked Goldman Sachs to update its analysis of alternatives for improving Premera's capital base;

(8) Goldman Sachs' updated report, delivered in preliminary form in August 2001 and in final form in September 2001, again examined a wide range of capital enhancement alternatives, including a survey of potential business combination candidates and the business and legal pros and cons of each;

(9) the Premera Board discussed and considered each of these potential business combinations on their own merits, taking into account the following principal criteria to assess their relative desirability:

first, the degree to which the potential combination would deliver (a) greater capital strength and flexibility, (b) improved performance in terms of operating efficiencies and service delivery, and (c) improved competitiveness for the Premera business;

second, whether the potential combination would allow for continuation of the competitive advantage of operating under a Blue Cross Blue Shield ("BCBS") license;

third, the degree of difficulty of achieving regulatory and antitrust approvals of the potential combination; and

fourth, the degree to which Premera's business would continue to be under local control after the combination or, conversely, the degree to which the loss of local control would create uncertainties as to (a) possible future departure of the combined businesses from all or part of Premera's regional market (as a number of national competitors had done during the 1990's) or

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(b) the effect of the combination on Premera's various constituencies, such as employer groups, subscribers, family members, physicians and other provider constituencies;

(10) applying the first two of these criteria narrowed the candidates down to a very small number;

(11) WellPoint Health Networks Inc. and Anthem, Inc., both of which were publicly held for-profit corporations, presented the most arduous regulatory approval process (even more arduous than the Proposed Conversion);

(12) the Premera Board believed that a possible combination with a large, out-of-state BCBS licensee would result in a loss of local control, with all executive functions leaving the region and decisions that have local impacts no longer being made with particular attention to local needs and local economic considerations;

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(14) after considering all of these alternatives, and the information and analysis provided by Goldman Sachs, the Premera Board concluded that the Proposed Conversion was the one alternative that best met the four principal criteria that the Premera Board believed to be strategically important to Premera and its constituencies;

(15) no facts have come to the attention of the Premera Board since late 2001

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] that have caused the Premera directors to believe that there are any superior alternatives for achieving these strategic objectives; and

(16) the decisions made by the Premera Board during this period of deliberation as to Premera's strategic alternatives were made by the Premera Board (not by management), do not appear to have been influenced by self interest, and were certainly not made in haste or on the basis of inadequate information or deliberation.

b. *The Premera Board's Standard of Care, and the Business Judgment Rule.* The general standard of care for Premera's directors is set forth in the statutes under which each corporation is organized.³ In general, each of Premera's directors must discharge his or her duty in good faith, in

³ Under RCW Ch. 24.06, the statute under which PREMERA is organized, each of PREMERA's directors must discharge his or her duty "(a) [i]n good faith; (b) [w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (c) [i]n a manner the director . . . reasonably believes to be in the best interests of the corporation." RCW 24.06.153(1). Under RCW Ch. 24.03, the statute under which Premera BC is organized, each director of Premera BC must perform his or her duties "in good faith, in a manner such director believes to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances." RCW 24.03.127.

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a manner the director reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances. There is very little case law in Washington that provides any meaningful guidance as to the application of this standard to directors of not-for-profit corporations. As a result, reference must be made to the substantially identical wording found in Washington's for-profit corporations statute.⁴ Since there is also relatively little Washington case law concerning the duties of directors of for-profit corporations, most Washington practitioners and even Washington courts typically seek supplementary guidance from the fiduciary duty interpretations of the Delaware courts.⁵

In general, directors who act in good faith, on an informed and deliberative basis, and free of self-interest are entitled to claim the protection of the so-called "business judgment rule." This rule shields directors' business decisions from "second guessing" by the courts, even if those decisions are demonstrably erroneous, so long as they can be attributed to any rational business purpose.⁶ Unless there is evidence that the directors have not met their standard of care, as a matter of principle it is considered not reasonable for judicial bodies to reexamine such decisions with the benefit of hindsight.⁷

Based upon my review of the background materials and information available to me, I believe that the Premera Board's deliberative process (as described above) met the requisite standard of care, and that its decision to pursue the Proposed Conversion rather than other business combination alternatives should be entitled to the protection of the business judgment rule. Despite the suggestions in the C&B Report, I see no indication that the Washington Legislature intended the "second guessing" that is arguably authorized by RCW Ch. 70.45 as to non-profit hospital conversions to apply in hearings by any agencies other than the Department of Health,⁸ nor do I see any other reason why the Premera Board's decision should not be accorded the same deference that a corporate decision would be accorded in any other legal proceeding.

c. *Inapplicability of Heightened Duty to Explore Other Combinations.* The duty of a board of directors in the context of a merger or sale of a company is a familiar topic of discussion in both the financial press and judicial decisions in various jurisdictions. One commonly hears references—similar to those in the C&B Report—concerning the directors' duty to conduct an extremely thorough search of disposition alternatives in an effort to maximize value for shareholders.

⁴ RCW 23B.08.300(1).

⁵ See, e.g., *Leppaluoto v. Eggleston*, 57 Wn.2d 393, 357 P.2d 725 (1960); *Para-Medical Leasing, Inc. v. Hagen*, 48 Wn. App. 389, 739 P.2d 717 (1987).

⁶ *Nursing Home Bldg. Corp. v. DeHart*, 13 Wn. App. 489, 535 P.2d 137 (1975); *Seafirst Corp. v. Jenkins*, 644 F. Supp. 1152 (W.D. Wash. 1986); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

⁷ "Unless there is evidence of fraud, dishonesty, or incompetence (i.e., failure to exercise proper care, skill, and diligence), courts generally refuse to substitute their judgment for that of the directors." *Spokane Concrete Prod., Inc. v. U.S. Bank*, 126 Wn.2d 269, 279, 892 P.2d 98 (Wash. 1995).

⁸ At the time Washington adopted RCW Ch. 70.45, a number of other states had proposed or adopted similar legislation that applied to not only non-profit hospital conversions but also conversions of non-profit health insurers (such as Blue Cross organizations), yet the Washington Legislature refrained from so expanding RCW Ch. 70.45.

The notion that a board of directors, confronted with a decision to sell a corporation or its business, must adhere to a standard of care higher than the normal "business judgment" standard (as discussed above), and must conduct a thorough investigation of alternative dispositions in an effort to achieve maximum short-term value (so-called "Revlon" duties), has its origins in Delaware case law.⁹ Although I am not aware of any case law to this effect, this heightened duty of inquiry may well be just as applicable to directors of not-for-profit corporations as it is to directors of for-profit corporations.

However, it is critical to note that the courts have applied these heightened duties in only a few very well-defined situations:

- *where the board has decided to sell or break up the company (or that sale or break-up is inevitable);*¹⁰
- *where a proposed transaction will result in a sale or a change in control;*¹¹ and
- *where a proposed transaction will result in stockholders losing the opportunity to receive a control premium in a later transaction.*¹²

However, in the case of the Proposed Conversion, none of these Revlon scenarios is applicable for the following reasons:

- The Premera Board has never decided that the company must be sold, and in fact believes in good faith that there are a number of important business reasons for Premera to remain under local control and independent from larger national competitors.¹³

⁹ See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* ("Revlon"), 506 A.2d 173 (Del. 1986). See also, e.g., *Mills Acquisition Co. v. Macmillan, Inc.* ("Macmillan"), 559 A.2d 1261 (Del. 1989); *Paramount Communications, Inc. v. QVC Network, Inc.* ("QVC"), 637 A.2d 34 (Del. 1993).

¹⁰ *Revlon*, 506 A.2d at 182.

¹¹ See *QVC*, 637 A.2d at 42-43, 47. A cash merger or other business combination in which stockholders are cashed out, or in which a single stockholder or affiliated group of stockholders of the corporation control the voting power of a surviving entity, is generally viewed as a "sale of control."

¹² *QVC*, 637 A.2d at 43-45.

¹³ Generally speaking, a board of directors has no duty to negotiate with a party seeking to acquire a company, even when that prospective bidder is offering to acquire the company at a substantial premium. For example, in *Paramount Communications, Inc. v. Time, Inc.* ("Time"), 571 A.2d 1140 (Del. 1989), the Delaware Supreme Court ruled that the Time board "was under no obligation to negotiate with Paramount" and that its "failure to negotiate cannot be fairly found to have been uninformed." *Time*, 571 A.2d at 1154. In evaluating strategic alternatives, a board may consider, among other things, "the adequacy and terms of the offer; its fairness and feasibility; the proposed or actual financing for the offer, and the consequences of that financing; questions of illegality; the impact of both the bid and the potential acquisition on other constituencies, provided that it bears some reasonable relationship to general shareholder interests; the risk of nonconsum[er]ation; the basic stockholder interests at stake; the bidder's identity, prior background and other business venture experiences; and the bidder's business plans for the corporation and their effects on stockholder interests." *Macmillan*, 559 A.2d at 1282 n. 29. "Circumstances may dictate that an offer be rebuffed, given the nature and timing of the offer; its legality, feasibility and effect on the corporation and the stockholders; the alternatives available and their effect on the various constituencies, particularly the (footnote continued on next page)

- o The Proposed Conversion does not involve a "change of control" for Revlon purposes¹⁴ because those persons who are in actual control of Premera before the Proposed Conversion (namely the Premera Board members) will still be in control of the business after the Proposed Conversion. C&B asserts that the general public owns a not-for-profit corporation in the State of Washington. I know of no authority under Washington law that supports this view.¹⁵ Even if one looks beyond actual control and examines whether there is a change of "ownership," the Proposed Conversion still involves no change of control for Revlon purposes because, at most, ownership is merely migrating from one amorphous group to a large, fluid, changeable and changing market of unaffiliated public shareholders.¹⁶
- o Finally, the Proposed Conversion will not result in the loss of an opportunity to receive a control premium in a later transaction because Premera's stakeholders have no present ability to influence corporate direction or demand a control premium,¹⁷ and the Proposed Conversion will actually increase the likelihood that a control premium may be achieved.¹⁸

(footnote continued from previous page)

stockholders; the company's long term strategic plans; and any special factors bearing on stockholder and public interests." Id. at 1285 n. 35. "The fiduciary duty to manage a corporate enterprise includes the selection of a time frame for achievement of corporate goals. That duty may not be delegated to the stockholders." Time, 571 A.2d at 1154. "[D]irectors are entitled to select the transaction that they believe provides stockholders with the best long-term prospects for growth and value enhancement with the least amount of downside risk." David A. Katz, "Takeover Law and Practice 2001" (prepared for the American Bar Association Center for Continuing Legal Education seminar on Negotiating Business Transaction, New Orleans, Louisiana, November 15-16, 2001) ("Katz") at 53.

¹⁴ The determination of whether there is a change of control for purposes of this analysis is not necessarily the same as or governed by the similar-sounding determination for OIC regulatory purposes.

¹⁵ If the Insurance Commissioner would like to hear testimony on my opinions regarding the ownership of a not-for-profit corporation, I will be prepared to address his questions.

¹⁶ Delaware courts have held that a sale of control is not generally implicated in a "stock for stock" merger, where a majority of the shares in the continuing entity will continue to be held after the merger by a "fluid aggregation of unaffiliated shareholders representing a voting majority," even if the target stockholders will represent only a minority of the ongoing entity. Time, 571 A.2d at 1150. See also, Arnold v. Society for Savings Bancorp ("Society for Savings"), 650 A.2d 1270, 1290 (Del. 1994). "[T]here is no 'sale or change in control' when '[c]ontrol of both [companies] remain[s] in a large, fluid, changeable and changing market.'" Id. at 1290, quoting Paramount Communications Inc. v. Time Inc., Del.Ch. No. 10866, 1989 WL 79880, Allen (July 17, 1989) (citation and emphasis omitted). See also QVC, 637 A.2d at 43, 46-47.

¹⁷ See QVC, 637 A.2d at 43.

¹⁸ In my view, the control premium likely to be offered for a publicly traded for-profit corporation would be greater than the premium likely to be offered for a not-for-profit corporation, because the former would be stronger from a financial and negotiating standpoint and the latter would not yet have been through the regulatory process for conversion to for-profit status. In addition, there is no question that, immediately after the Proposed Conversion, the Foundation Shareholder will, as the holder of a majority of New PREMERA's shares, still be able to achieve a control premium if the business is sold. This will continue to be true even as the Foundation Shareholder's percentage ownership gradually declines, since all shareholders typically participate in the receipt of the control premium when a public company is sold. The fact that there will be contractual provisions requiring the Foundation Shareholder's holdings to be liquidated over a lengthy period of time following the Proposed Conversion does not, in my view, trigger Revlon duties.

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Since none of these scenarios applies to the Proposed Conversion, the standard of care applicable to the Premera Board's deliberative process is the "business judgment" standard, not the heightened Revlon standard. In the absence of Revlon duties, it is well-established that a board of directors is: (i) not required to conduct an in-depth "market check" for possible sale opportunities; (ii) not required to sell the business in an effort to maximize short-term value for shareholders;¹⁹ (iii) permitted to pursue alternate structures or transactions designed to create long-term value for stockholders; (iv) not required to focus solely on financial value and may take into account the best interests of other "constituencies" of the business (such as Premera's employer groups, subscribers, family members, physicians and other provider constituencies);²⁰ and (v) under no obligation to respond to or even investigate offers for a near-term acquisition or combination that would be inconsistent with or a diversion from the board's long-term strategic vision.²¹

2. The provisions of the Articles of Incorporation and Bylaws of the Foundation Shareholder and the Washington Charitable Organization relating to indemnification of their officers and directors are commonplace among large Washington corporations and serve a beneficial purpose enabling the recruitment and retention of the most qualified and sophisticated directors.

The C&B Report calls out a number of respects in which the proposed Articles and Bylaws of the Foundation Shareholder and the Washington Charitable Organization exceed the "base line" indemnity rights that are prescribed in the applicable corporate statutes (as the default rules that apply in the absence of a broader authorization). Without addressing each of these provisions in minute detail, let me simply offer my view that, on the whole, the provisions complained of in the C&B Report are of a type and tenor commonly found in the Articles and Bylaws of large Washington corporations.

The C&B Report also raises the question whether, even though such broader indemnification provisions may be common, they serve the public interest in this particular case. In my view, they do, especially in these difficult times when corporate directors are under such intense scrutiny and are so vulnerable to the threat of litigation. I believe that customary indemnification rights will not only be expected, but demanded, by even marginally sophisticated candidates for the boards of these entities, and will therefore be a prerequisite to the recruitment of highly qualified directors willing to devote their time to the important work of the Foundation Shareholder and the Washington Charitable Organization. These corporations will not, in my view, be able to attract the caliber of directors they desire if they are prevented from offering board candidates the same protections they would receive from other similarly sized enterprises.

¹⁹ "[A]bsent a limited set of circumstances as defined under Revlon, a board of directors, while always required to act in an informed manner, is not under any per se duty to maximize shareholder value in the short term, even in the context of a takeover." Time, 571 A.2d at 1150, 1154.

²⁰ "In stock mergers not involving a change of control, directors may appropriately consider the effect of the transaction on non-stockholder constituencies. In seeking to achieve stockholder value, directors are permitted to take into account the impact of the prospective transaction on the company, its employees, its customers and the community in which it operates." Katz at 55, citing, for example, Time, 571 A.2d at 1150, 1152.

²¹ "Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy." Time, 571 A.2d at 1154.

3. The provisions of the Bylaws of the Foundation Shareholder and the Washington Charitable Organization creating a presumption of assent to board actions under certain circumstances are consistent with public policy under Washington corporations law and are not a potential instrument of abuse.

The C&B Report raises a question as to whether Section 4.6(a) of the Bylaws of the Foundation Shareholder and the Washington Charitable Organization (which allows a director present at a board meeting to avoid a presumption that he or she has assented to action taken thereat if the director objects to the conduct of business at the beginning of or upon arrival at the meeting) may be unduly narrow because its wording is inconsistent with RCW 24.03.120 (which states that a director's attendance at a meeting constitutes a waiver of due notice of the meeting unless the director attends for the express purpose of objecting to the legitimacy of the meeting). The C&B Report recommends that Bylaw Section 4.6(a) be rewritten in order to conform its wording to that of RCW 24.03.120. The C&B Report's cover letter suggests that, because of the lack of independence of the Foundation Shareholder's board members from New PREMERA, the presumption of assent provisions of the Bylaws should be narrower.

In my view, there is no inconsistency identified by the C&B Report, and no revision of Bylaw Section 4.6(a) is required or even desirable. RCW 24.03.120 discusses the circumstances under which a director may attend a board meeting without having his or her attendance amount to a consent to the holding of an otherwise defectively called meeting—in other words, it relates to the question of whether a meeting is properly called so as to allow any action to be taken at the meeting. Bylaw Section 4.6(a), by contrast, relates to the situation where a meeting is properly called, so that business can be transacted, but then elaborates on the circumstances under which a director may lodge a formal dissent or abstention from action taken at the meeting. These are two quite different concepts and applications, and there is no particular reason why the circumstances under which presumed-assent is avoided need to be worded identically to the circumstances for avoiding consent to a defectively called board meeting. Note that the comparable provisions of the for-profit corporations statute, RCW 23B.08.230(2) and 23B.08.240(4)(a), reflect exactly the same difference in language as between these two quite different applications.

Given the identity of language to that found in the comparable provisions of RCW Title 23B, the wording of Section 4.6 of the Bylaws is clearly not inconsistent with established public policy in Washington. Nor, as the C&B Report suggests, do these Bylaw provisions present any opportunity for abuse of the governance processes of the Foundation Shareholder. The C&B Report cover letter suggests that the presumption of assent needs to be narrowed, but this is in fact the precise purpose and effect of Bylaw Section 4.6(a), which limits the circumstances under which a director may be presumed to have assented to corporate action. The wording used to describe this limitation in the Bylaws is the same as that used by the Washington Legislature for application to directors of for-profit corporations, and is commonplace among large Washington corporations.

4. The provisions of the Articles of Incorporation of the Foundation Shareholder relieving its directors from any "prudent person" obligation to diversify its holdings of stock in New PREMERA are drafted with narrowly targeted language, and are almost certainly necessary in order to attract sophisticated directors to serve on the Foundation Shareholder's board of directors.

Under the structure of the Proposed Conversion, the Foundation Shareholder will hold a concentration of shares of New PREMERA stock, which will begin at 100% of its assets and will

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remain at or about that level even as it disposes of shares (since it will be required to distribute cash sale proceeds promptly to the Charitable Organizations). Since the Foundation Shareholder is effectively required to maintain this concentration of assets, and has no means for otherwise diversifying its asset holdings, it is essential that its directors not be held to the typical "prudent person" duty to diversify assets held in a fiduciary capacity. Without a release of this obligation under RCW 11.100.020, the Foundation Shareholder's directors could be exposed to personal liability for failure to diversify a portfolio they have no practical ability to diversify. Such a release cannot, in my judgment, be impliedly achieved through a general approval of the Proposed Conversion by the Insurance Commissioner.

Of course, it is important that any such release be narrowly drawn so that it does not overly relax prudence standards that should govern the directors' management of other assets (e.g., cash funds awaiting distribution). Having reviewed the release language in the proposed Articles of Incorporation of the Foundation Shareholder, I believe that the release is so narrowly drawn. The C&B Report (p. 45) seems to acknowledge that, as drafted, the "prudent person" standard would still apply as to all assets other than the New PREMERA shares. Such a narrowly drawn provision does not, in my view, bear any potential for the Foundation Shareholder's directors to engage in any "imprudent" conduct other than continuing to hold a concentration of New PREMERA shares. Therefore, it raises no public interest concerns.

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Schedule A

Materials Reviewed

1. Form A (Statement Regarding the Acquisition of Control of a Domestic Health Carrier and a Domestic Insurer), filed by New PREMERA with the OIC on September 17, 2002;
2. Supplementary materials filed by New PREMERA as part of the same Form A submission on September 27, 2002;
3. Supplementary materials filed by New PREMERA as part of the same Form A submission on October 25, 2002;
4. Preliminary and final reports from C&B concerning the Form A Filing, dated October 3, 2003 and October 27, 2003;
5. Letter from Preston Gates & Ellis LLP to the OIC commenting on C&B's preliminary report, dated October 15, 2003;
6. Report of The Blackstone Group to the OIC as to valuation and fairness issues relating to the Form A Filing, dated October 27, 2003;
7. Goldman Sachs' "Project Cascade" presentation to the Premera Board, dated September 10, 1997;
8. Goldman Sachs' "Project Cascade – Capital Alternatives" presentation to the Premera Board, dated November 12, 1997;
9. Goldman Sachs' presentation to the Premera Board, dated August 8, 2001;
10. Goldman Sachs' presentation to the Premera Board, dated September 9, 2001;
11. Goldman Sachs' report on discussion materials for the Premera Board, dated September 9, 2001;
12. Business Case Review, Materials prepared for the Premera Board, May 14, 2002;
13. Background information relative to the history of the deliberative process of the Premera Board provided in a two-hour interview of PREMERA's Chief Financial Officer, Mr. Kent Marquardt, on November 4, 2003;
14. Background information relative to the history of the deliberative process of the Premera Board provided in a one-hour interview of the Premera Board's Lead Director, Ms. Sally Jewell, on November 9, 2003;
15. Precedents Comparison, comparing the Proposed Conversion to other similar prior conversions, prepared by Sullivan & Cromwell LLP, dated October 20, 2003;
16. The following Articles of Incorporation and Bylaws of Premera BC, PREMERA and certain of their affiliates:

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- a. Restated Articles of Incorporation of PREMERA, filed with the Secretary of State of the State of Washington on June 30, 1998;
- b. Amended and Restated Bylaws of PREMERA, effective as of May 14, 2003;
- c. Amended and Restated Bylaws of PREMERA, effective as of October 8, 2002;
- d. Amended and Restated Bylaws of PREMERA, effective as of August 14, 2002;
- e. Amended and Restated Bylaws of PREMERA, effective as of February 14, 2001;
- f. Restated Articles of Incorporation of Premera BC, filed with the Secretary of State of the State of Washington on June 30, 1998;
- g. Amended and Restated Bylaws of Premera BC, effective as of May 14, 2003;
- h. Amended and Restated Bylaws of Premera BC, effective as of October 8, 2002;
- i. Amended and Restated Bylaws of Premera BC, amended effective as of February 14, 2001;
- j. Articles of Incorporation of PremeraFirst, Inc. (f/k/a Service-First Intermediary Co.), filed with the Secretary of State of the State of Washington on February 13, 1989, and amended on July 7, 1997 and January 18, 2000;
- k. Bylaws of PremeraFirst, Inc. (f/k/a Service-First Intermediary Co.), dated February 15, 1989, as amended on July 7, 1997, April 26, 1999, and November 25, 2002;
- l. Restated Articles of Incorporation of NorthStar Administrators, Inc. (f/k/a N.C.A.S. – Northwest, Inc.), filed with the Secretary of State of the State of Washington on April 20, 1989, and amended on January 18, 2000 and March 6, 2000;
- m. Amended Bylaws of NorthStar Administrators, Inc. (f/k/a N.C.A.S. – Northwest, Inc.), dated March 29, 1989, as amended as of October 1, 2001;
- n. Restated Articles of Incorporation of Washington-Alaska Group Services, Inc., filed with the Secretary of State of the State of Washington on May 22, 1989, and amended on January 18, 2000;
- o. Amended Bylaws of Washington-Alaska Group Services, Inc., dated March 29, 1989, as amended on November 25, 2002;
- p. Articles of Incorporation of Calypso Healthcare Solutions (f/k/a Quality Solutions), filed with the Secretary of State of the State of Washington on August 30, 2000, and amended on June 2, 2003;
- q. Bylaws of Calypso Healthcare Solutions (f/k/a Quality Solutions), dated as of September 1, 2000;

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- r. Restated Articles of Incorporation of LifeWise Assurance Company (f/k/a States West Life Insurance Company), filed with the OIC on May 9, 1989, and filed with the Secretary of State of the State of Washington on May 10, 1989, and amended on January 24, 2000, February 3, 2000 and August 25, 2003;
 - s. Amended Bylaws of LifeWise Assurance Company (f/k/a States West Life Insurance Company), dated September 24, 2003;
 - t. Restated Articles of Incorporation of LifeWise Health Plan of Washington (f/k/a Premera Healthcare and Premera LifeWise Health Plan), filed with the Secretary of State of the State of Washington on May 2, 2000, and amended on January 8, 2001 and July 11, 2002;
 - u. Amended and Restated Bylaws of LifeWise Health Plan of Washington (f/k/a Premera Healthcare and Premera LifeWise Health Plan), effective as of August 3, 2000;
 - v. Articles of Incorporation of LifeWise Administrators, filed with the Secretary of State of the State of Washington on June 27, 2002;
 - w. Bylaws of LifeWise Administrators, dated June 27, 2002;
 - x. Articles of Incorporation of LifeWise Health Plan of Arizona, Inc. (f/k/a MSC Life Insurance Company), filed with the OIC on June 1, 1992, and filed with the Secretary of State of the State of Washington on June 8, 1992, as amended on January 11, 2000, January 9, 2003, and March 17, 2003;
 - y. Amended Bylaws of LifeWise Health Plan of Arizona, Inc. (f/k/a MSC Life Insurance Company), dated August 13, 2003;
 - z. Articles of Incorporation LifeWise Health Plan of Oregon, Inc. (f/k/a Pacific Health & Life Insurance Company), dated July 29, 1986, filed with the Office of the Insurance Commissioner of the State of Oregon on August 7, 1986, as amended on May 16, 1988, May 6, 1994, May 29, 1997, and February 8, 2002; and
 - aa. Bylaws of LifeWise Health Plan of Oregon, Inc. (f/k/a Pacific Health & Life Insurance Company).
17. Minutes of the meetings of Premera BC Board held on the following dates:
- a. May 13 – 14, 2003;
 - b. February 11 – 12, 2003;
 - c. December 11, 2002;
 - d. May 15, 2002;
 - e. May 14, 2002;

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- f. February 12 – 13, 2002;
 - g. January 24, 2002;
 - h. December 12, 2001;
 - i. September 9 – 10, 2001;
 - j. August 8, 2001; and
 - k. May 9, 2001.
18. Minutes of the meetings of the Governance Committee of the Premera BC Board held on the following dates:
- a. May 13, 2003;
 - b. April 4, 2003;
 - c. February 11, 2003;
 - d. December 10, 2002;
 - e. February 12, 2002; and
 - f. January 23, 2002.
19. Minutes of the meetings of the Investment, Audit & Compliance Committee of the Premera BC Board held on the following dates:
- a. May 13, 2003;
 - b. April 21, 2003;
 - c. February 11, 2003;
 - d. February 5, 2003; and
 - e. December 10, 2002.
20. Minutes of the meetings of the PREMERA Board held on the following dates:
- a. May 13 – 14, 2003;
 - b. February 11 – 12, 2003;
 - c. December 11, 2002;
 - d. May 15, 2002;

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- e. May 14, 2002;
 - f. February 12 – 13, 2002;
 - g. December 12, 2001;
 - h. September 9 – 10, 2001;
 - i. August 8, 2001;
 - j. May 9, 2001;
 - k. October 2 – 3, 2000 (Board Retreat);
 - l. October 2, 2000 (Special Meeting);
 - m. November 12, 1997;
 - n. September 9 – 10, 1997; and
 - o. February 13, 1997.
21. Minutes of the meetings of the Governance Committee of the PREMERA Board held on the following dates:
- a. May 13, 2003;
 - b. February 11, 2003;
 - c. December 10, 2002;
 - d. February 12, 2002; and
 - e. January 23, 2002.
22. Minutes of the meetings of the Executive and Governance Committee of the PREMERA Board held on the following dates:
- a. December 5, 2000;
 - b. October 3, 2000; and
 - c. August 15, 2000.
23. Minutes of the meetings of the Investment, Audit & Compliance Committee of the PREMERA Board held on the following dates:
- a. May 13, 2003;
 - b. April 21, 2003;

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- c. February 11, 2003;
 - d. February 5, 2003; and
 - e. December 10, 2002.
24. Minutes of the meetings of the Quality Committee of the PREMERA Board held on the following dates:
- a. May 13, 2003;
 - b. February 11, 2003; and
 - c. December 10, 2002.
25. Minutes of the meetings of members of PREMERA held on the following date:
- a. May 15, 2002.
26. Minutes of the meetings of the board of directors of Blue Cross of Washington and Alaska held on the following dates:
- a. November 12, 1997; and
 - b. February 13, 1997.
27. Minutes of the meetings of the board of directors of Medical Service Corporation of Eastern Washington held on the following dates:
- a. November 12, 1997;
 - b. October 30, 1997; and
 - c. February 13, 1997.

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